

Week Ahead: Rate hike in the cards

OTTAWA -- Two major announcements bookending the coming week's economic news will provide a clearer snapshot of the state of the Canadian recovery.

The Bank of Canada will be first up when it makes its monthly interest rate announcement on Tuesday. But that will come before Friday's critical report from Statistics Canada on the country's consumer price index for June.

The central bank raised its benchmark index rate in June by 25 basis points, and at the time expectations were that the rate would increase steadily. But in the weeks since that announcement concerns about a double-dip recession have been growing, increasing speculation that the bank would hold the course. Consensus expectation is for a 25 basis-point increase on Tuesday, bringing the rate to 0.75%, though analysts disagree on what will happen as the year unfolds.

"While both domestic and global conditions have deteriorated modestly since June, the underlying momentum in the Canadian economy warrants the continued normalization of policy in the near term," wrote strategist David Tulk of TD Securities in a note to investors. "When we look further into the future, the impact of financial market turmoil and decelerating economic growth is more difficult to quantify. In recognition of this uncertainty, we have scaled back our forecast for rate increases, and now look for a year-end overnight rate of 1.25% and a rate of 2.50% by the end of 2011."

Economist Michael Gregory of BMO Economics, who also calls for another 25 basis point increase, said he expects the bank to make one more increase of that size in September then hold the line for the remainder of the year. CIBC is calling for the rate to reach 1.25% in October, followed by a pause lasting at least two quarters.

The Bank of Canada's rate announcement will come ahead of the key June inflation report on Friday. The consensus expectation is for 0.1% month-over-month drop in the consumer price index on lower gasoline prices, while the core year-over-year inflation rate will be unchanged at 1.8%, below the Bank of Canada's target of two%.

CIBC economist Krishen Rangasamy said that while the rate announcement will precede the CPI, he doesn't expect the "milder" June prices will have any effect on the rate. He said July's prices should get a bounce from the harmonized sales tax introduced on July 1 in Ontario in British Columbia.

The bank will also release its Monetary Policy Report on Thursday. Mr. Rangasamy doesn't expect the bank to make material changes to its April forecast of 3.5% growth for the second half.

"The only thing will be perhaps in the tone of the report. We think that they might adopt a more cautious tone on the external environment, particularly what's happening in Europe and elsewhere, with slower Chinese growth, so they might adopt a little bit more cautious tone as opposed to their upbeat tone in April."

Statistics Canada reports in the coming week include securities transactions on Monday, travel data on Tuesday, wholesale trade on Wednesday, as well as employment insurance and retail trade data on Thursday.

On the corporate front, some major Canadian companies will be reporting earnings on Thursday, including Canadian National Railway, Shoppers Drug Mart and Loblaw Cos.